# Budgetary Balance: The Norm, Concept, and Practice in Large U.S. Cities

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*How does budgetary balance affect the budgetary process? Is budgetary balance in fact the ideal and empirical reality portrayed in the prescriptive and descriptive literature on municipal budgeting? This study confirms empirically the pivotal role of balance and details its operation in the 100 most populous cities in the United States. Bridgeport's brush with bankruptcy demonstrates the limits of balance and how it differs from insolvency. It indicates that the court's ruling narrowed access to bankruptcy protection for municipalities legally required to adopt a balanced budget. This city's experience with a stringent requirement for year-end balance is the backdrop for examining tactical devices aimed at achieving formalistic compliance with balanced budget requirements and cautions against overrating the power of balance as budgetary disciplinarian. This study concludes that municipal budgetary behavior cannot be reduced fruitfully to a single criterion, even one as widely accepted as budgetary balance.*

## The Norm of Balance

The idea of budgetary balance is crucial to contemporary municipal budgeting in the United States. A concise metaphor for good government and a symbol of fiscal integrity and prudence, budgetary balance is pressed into service as a simple, summary measure of overall capacity to govern. A recent article in *The CPA Journal* notes, "The requirement of a balanced budget for governments is widely acclaimed as a means of achieving fiscal prudence and economy" (Granof and Mayper, 1991, p. 28, italics omitted). An article published by Moody's Investors Service proclaims budgetary balance to be "the key urban challenge" for this decade (Kennedy, 1991; 1-7).

The focus and clarity inherent in a single dimension no doubt contribute to the concept's prescriptive appeal. Capturing its allure in his 19th-century novel *David Copperfield*, Charles Dickens displays its arithmetic elegance: "Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

In more sophisticated analyses, balance represents more than arithmetic equivalency. Aaron Wildavsky (1992) interprets the chronic federal imbalance as evidence of deep political disagreement. The political functions attributed to balance include consensus building and enforcement. As disciplinarian, balance is "the most important constraint on budgeting" (Rubin, 1993; 164). Its absence customarily is interpreted as signaling that political will or political concord is absent as well. For these reasons (and perhaps because so few generalizations hold across municipalities), the conventional descriptive accent in municipal budgeting falls on budgetary balance. Cope (1992; 1099) states, "Most local governments are required by their charters, state laws, or both, to balance their operating budgets." Similarly, Rubin (1993; 198) comments, "Cities, like states, are required to balance their budgets."[1]

Is budgetary balance in fact the ideal and empirical reality portrayed in the prescriptive and descriptive literature on municipal budgeting? The precise meaning and potential impact of budgetary balance vary so widely among jurisdictions that component details are more informative than the generalization. Given possible permutations, how is balance operationalized in different municipalities? What patterns can be discerned?

To answer these and related questions, database searches and a telephone survey were conducted in fall 1992. Additional telephone calls to finance directors, budget officers, academic experts, and/or other knowledgeable informants were made where discrepancies or ambiguities indicated clarification was needed. Empirical evidence for the 100 most populous U.S. cities confirms and informs the general proposition that municipal budgets must be balanced.

### Formal Provisions

An efficient investigation logically begins with the most general applicable rules; here, they are state-imposed budget requirements. The results of the database search of state statutes and constitutions show that at least 20 states require balanced municipal budgets (Table 1).[2] The findings necessarily are ambiguous because of: regulatory or backdoor provisions unidentifiable through a search by key words or of statutes (such as in Massachusetts), ambiguity in the law or its application (e.g., Texas), variable treatment of different classes of municipalities (e.g., Connecticut), and the fact that home rule charters supersede state law in some instances (e.g., Virginia and Pennsylvania). Therefore, states not listed in Table 1 do not necessarily permit imbalance, and individual cities located in rostered states are not necessarily covered by the general state requirement. Nonetheless, the data in Table 1 establish that states prescribe municipal budgetary balance in many cases where the formal, obligatory standard cannot be said to be a norm of municipal budgeting *per se*.

**Table 1**
**States Requiring Balanced Municipal Budgets[a]**

| By Statute | By Constitution |
|---|---|
| Alabama | Idaho |
| Connecticut | Virginia |
| Georgia | Wyoming |
| Kansas | |
| Kentucky | |
| Massachusetts[b] | |
| Mississippi | |
| Montana | |
| New Hampshire | |
| North Dakota | |
| Ohio | |
| Oklahoma | |
| Oregon | |
| Pennsylvania | |
| Rhode Island | |
| Utah | |
| Wisconsin | |

a. Inclusion indicates that the state requirement applies to any or all classes of municipalities. For example, Connecticut's requirement applies only to municipalities with Boards of Finance. Special legislation for an individual city (e.g., New York City) does not trigger inclusion here.

b. A follow-up telephone survey was conducted in fall 1992. CA, TX, and OH, negative on the database search, together account for 19 (38 percent) of the 50 most populous cities in Table 2. According to the Office of the Attorney General in the respective state, OH constitutionally requires municipalities to balance their budgets; California has no statewide municipal requirement; and the response for TX is variable (and confirmed by the Houston respondent's volunteered observation reported in Table 2). According to the Division of Local Services of the Massachusetts Department of Revenue, all municipalities, including Boston, must balance their budgets to gain this department's certification of the tax rate and of compliance with the levy limit (Proposition 2 1/2); this indirect approach does not show up on a database search.

Source: Search of Lexis database conducted fall 1992 by key words: budget with municipal; budget; fund w/10 balance; deficit; surplus; appropriate; and balance w/10 budget. Supplemented by telephone interviews in selected states in fall 1992.

To supplement and enrich the database search, a telephone survey of finance or budget officers or analysts in the 100 most populous cities in the United States was conducted in fall 1992. Although almost all respondents replied at once that budgetary balance is required, many initially could not pinpoint specifics (and some graciously offered to research the information for the survey). This behavior suggests that balance is an accepted norm even in the absence of known legal requirements. In some instances, moreover, reported data were erroneous or contradictory, although this did not seem at all to the point for some respondents. One veteran finance professional spelled out his view of political and professional reality by explaining that the formal requirement was trivial compared to his community's insistence on balance. These interview experiences bear out that balance is a potent norm in municipal budgeting.

The budgetary balance requirements reported for the 100 most populous U.S. cities are reported in Table 2. All of the largest 50 cities and 99 of the 100 leading cities reported a balance requirement of some sort. The legal basis was reported as state law (53 percent) and/or city charter (58 percent). The dominance of California and Texas among the largest cities in Table 2, coupled with their absence from Table 1, colors any state-by-state analysis. All regions of the country are represented, although New England and the Mid-Atlantic states have relatively few cities on the roster.

Precisely when balance comes into play is one of the more important rules of the game in municipal budgeting. Table 2 displays the information for each city. Balance may be required upon submission, when the budget is adopted, for operating results (when a formal year-end deficit in the general fund is prohibited), or in some combination thereof. Each stage spotlights a different institution as responsible for meeting the standard: for submission, it is the executive; for adoption, the legislative body; and for operations, the municipal administration. More than four-fifths of the largest cities report requiring balance upon submission and/or adoption.

Because the constraint is more forceful the later it comes in the process, it is significant that more than one-third (34) of the most populous cities must balance operating results over the course of implementation. In effect, they are required to *rebudget* (Forrester and Mullins, 1992a, 1992b). For example, the city charter prohibits a year-end balance in San Francisco, where this provision offsets some credit risk (Table 2). "Projected and midyear [sic] budget imbalances have occurred three years in a row since the city depleted its general fund budgetary balance in fiscal 1991. Previous gaps were closed as the strict city charter dictates" and "[c]harter requirements mandate reserves and reinforce fiscal discipline by requiring [the] controller to withhold appropriations if revenues are insufficient" (Fitch Research, 1993b; 1, 3). Conspicuous by its premier population ranking, history of financial disarray, and restrictive balance requirement, New York City must rebalance quarterly to meet the provisions of the state's special legislation. The requirement to balance operating results annually is on the books in 44 percent (22) of the 50 most populous cities, compared with 24 percent (12) of the 50 next most populous cities.

The purpose here is to describe budgetary balance in the largest cities and identify patterns. Data in Table 3 bear out that population is not an explanatory variable (no balance requirement correlates significantly with population) but serves solely as the basis for selecting financially and politically interesting cities to describe. Frequency declines as stringency increases, except for adoption. The obvious disjuncture between the third and fourth columns speaks to the relative permissiveness of the balance requirement in the most populous cities.

An across-the-board obligation obviously is the most confining, but it also may diffuse responsibility by widely distributing it. As a tool of mutual restraint affecting strategy and outcomes for *all* participants *at every step*, budgetary balance is required at each of the three stages in the process in almost one-quarter (24) of the 100 most populous cities (see Table 3). State law and/or charter provisions apply and (again perhaps because of two states' dominance) no pattern is apparent in the legal source of the comprehensive requirement. Cities in every region of the country operate under a comprehensive balance requirement: Northeast/Mid-Atlantic, two; Southeast, six; Southwest, six; Midwest, six; and the Pacific region running from California to Alaska, four (Table 2).

## The Balance Model

The fundamental premise that balance describes the desirable relationship between revenues and expenditures is illustrated in simplified terms in Figure 1. This relationship is represented as configurations A and F in Figure 1. Referring to the Dicken's quote, Webber and Wildavsky (1986, p. 594) define *the Micawber principle*: "it is not the level of income and outgo but their relationship that matters [and] is essential to budgeting." The schematic representation of budgetary balance in Figure 1 summarizes the cumulative impact of the annual ritual described by Philip Dearborn (Shiff, 1991a). "The process of budget-

**Table 2**
**Reported Balanced Budget Requirements in the Most Populous U.S. Cities, 1992-1993**

| | | | | | Stage Required | | | |
|---|---|---|---|---|---|---|---|---|
| City[a] | Required | By State | By City Charter | Other | Submitted | Adopted | Year End[b] | Population Ranking |
| New York | yes | statute | yes | | yes | yes | yes[c] | 1 |
| Los Angeles | yes | | yes | | yes | yes | | 2 |
| *Chicago* | *yes* | *statute* | *yes* | | *yes* | *yes* | *yes* | *3* |
| Houston | yes | (d) | | (e) | yes | yes | | 4 |
| *Philadelphia* | *yes* | | *yes* | | *yes* | *yes* | | *5* |
| San Diego | yes | | yes | | | yes | | 6 |
| Detroit | yes | statute | yes | | yes | yes | | 7 |
| Dallas | yes | constitution | | | yes | yes | yes | 8 |
| Phoenix | yes | statute | | | | | yes | 9 |
| San Antonio | yes | | yes | | yes | yes | yes | 10 |
| San Jose | yes | (f) | (f) | | yes | yes | yes | 11 |
| Baltimore | yes | | | (g) | yes | yes | | 12 |
| Indianapolis | yes | statute | | | yes | yes | yes | 13 |
| San Francisco | yes | | yes | | yes | | yes | 14 |
| Jacksonville | yes | statute | yes | | yes | | | 15 |
| *Columbus, OH* | *yes* | *constitution* | | | *yes* | *yes* | *yes* | *16* |
| *Milwaukee* | *yes* | | *yes* | | *yes* | | | *17* |
| Memphis | yes | | yes | | yes | yes | | 18 |
| Washington DC | yes | | | (h) | yes | yes | | 19 |
| *Boston* | *yes* | *statute* | | | *yes* | | | *20* |
| Seattle | yes | statute | | | yes | yes | yes | 21 |
| El Paso | yes | statute | yes | | | yes | | 22 |
| *Cleveland* | *yes* | *statute* | | | *yes* | *yes* | | *23* |
| New Orleans | yes | | yes | | yes | | | 24 |
| Nashville | yes | | yes | | yes | yes | | 25 |
| Denver | yes | | yes | | yes | yes | yes | 26 |
| Austin | yes | statute | | | yes | yes | | 27 |
| Fort Worth | yes | | yes | | yes | yes | | 28 |
| *Oklahoma City* | *yes* | | | | | *yes* | *(i)* | *29* |
| *Portland* | *yes* | *statute* | *yes* | | *yes* | *yes* | *yes* | *30* |
| Kansas City, MO | yes | | yes | | yes | yes | yes | 31 |
| Long Beach | yes | | yes | | | | yes | 32 |
| Tucson | yes | statute | yes | | yes | yes | yes | 33 |
| St. Louis | yes | | yes | | yes | yes | | 34 |
| Charlotte | yes | statute | | | yes | yes | | 35 |
| *Atlanta* | *yes* | *statute* | | | *yes* | *yes* | | *36* |
| *Virginia Beach* | *yes* | *constitution* | *yes* | | *yes* | *yes* | | *37* |
| Albuquerque | yes | statute | | | yes | | yes | 38 |
| Oakland | yes | | yes | | yes | yes | yes | 39 |
| *Pittsburgh* | *yes* | | *yes* | | *yes* | | | *40* |
| Sacramento | yes | | yes | | yes | yes | | 41 |
| Minneapolis | yes | statute | yes | | yes | yes | | 42 |
| Tulsa | yes | statute | | | yes | yes | yes | 43 |
| Honolulu | yes | | yes | | yes | yes | | 44 |
| *Cincinnati* | *yes* | *statute* | | | *yes* | *yes* | *yes* | *45* |
| Miami | yes | statute | yes | | yes | yes | | 46 |
| Fresno | yes | | yes | | yes | yes | | 47 |
| Omaha | yes | | yes | | | | yes | 48 |
| *Toledo* | *yes* | | *yes* | | *yes* | *yes* | | *49* |
| Buffalo | yes | | yes | | yes | yes | yes | 50 |

(Table 2 is continued on the next page.)

**Table 2 (continued)**
**Reported Balanced Budget Requirements in the Most Populous U.S. Cities, 1992-1993**

| City[a] | Required | By State | By City Charter | Other | Stage Required Submitted | Adopted | Year End[b] | Population Ranking |
|---|---|---|---|---|---|---|---|---|
| *Wichita* | *no* | | | | | | | *51* |
| Santa Ana | yes | | yes | | yes | yes | | 52 |
| Mesa | yes | statute | | | yes | yes | | 53 |
| Colorado Springs | yes | statute | yes | | yes | yes | | 54 |
| Tampa | yes | statute | | | yes | yes | | 55 |
| Newark | yes | statute | | | | | yes | 56 |
| St. Paul | yes | | yes | | yes | yes | | 57 |
| *Louisville* | *yes* | *statute* | | | *yes* | *yes* | | *58* |
| Anaheim | yes | | yes | | yes | yes | | 59 |
| *Birmingham* | *yes* | | *yes* | | *yes* | *yes* | | *60* |
| Arlington, TX | yes | | (e) | | yes | yes | | 61 |
| *Norfolk* | *yes* | *constitution* | *yes* | | *yes* | *yes* | *yes* | *62* |
| Las Vegas | yes | statute | | | yes | yes | | 63 |
| Corpus Christi | yes | | yes | | yes | yes | | 64 |
| St. Petersburg | yes | statute | | | yes | yes | | 65 |
| Rochester | yes | statute | yes | | yes | yes | | 66 |
| Jersey City | yes | | yes | | yes | yes | | 67 |
| Riverside | yes | | yes | | yes | yes | | 68 |
| Anchorage | yes | | yes | | yes | yes | yes | 69 |
| Lexington-Fayette | yes | statute | yes | | yes | yes | | 70 |
| *Akron* | *yes* | *statute* | *yes* | | *yes* | *yes* | | *71* |
| Aurora | yes | statute | yes | | yes | yes | | 72 |
| Baton Rouge | yes | statute | | | yes | yes | yes | 73 |
| Stockton | yes | | yes | | yes | yes | | 74 |
| Raleigh | yes | statute | | | yes | | | 75 |
| *Richmond* | *yes* | *const., stat.* | *yes* | | *yes* | *yes* | *yes* | *76* |
| Shreveport | yes | | yes | | yes | yes | | 77 |
| *Jackson* | *yes* | *statute* | | | *yes* | *yes* | | *78* |
| *Mobile* | *yes* | *statute* | | | *yes* | *yes* | *yes* | *79* |
| Des Moines | yes | statute | | | yes | yes | | 80 |
| Lincoln | yes | statute | | | | yes | yes | 81 |
| *Madison* | *yes* | *statute* | | | *yes* | *yes* | *yes* | *82* |
| Grand Rapids | yes | (f) | (f) | | yes | yes | | 83 |
| Yonkers | yes | statute | yes | | yes | yes | | 84 |
| Hialeah | yes | statute | | | yes | yes | | 85 |
| *Montgomery* | *yes* | *statute* | | | *yes* | *yes* | *yes* | *86* |
| Lubbock | yes | | | | | yes | | 87 |
| Greensboro | yes | statute | yes | | | yes | yes | 88 |
| *Dayton* | *yes* | | *yes* | | | *yes* | | *89* |
| Huntington Beach | yes | | yes | | yes | yes | | 90 |
| Garland | yes | | yes | | yes | yes | | 91 |
| Glendale | yes | | yes | | yes | yes | | 92 |
| *Columbus, GA* | *yes* | *statute* | | | *yes* | *yes* | | *93* |
| Spokane | yes | statute | | | | yes | yes | 94 |
| Tacoma | yes | statute | | | | yes | | 95 |
| Little Rock | yes | statute | | | | | yes | 96 |
| Bakersfield | yes | | yes | | yes | yes | | 97 |
| Freemont | yes | | yes | | yes | yes | | 98 |
| Fort Wayne | yes | statute | | | | yes | | 99 |
| *Arlington, VA* | *yes* | *constitution* | *yes* | | *yes* | *yes* | *yes* | *100* |
| Total | 99 | 53 | 58 | | 84 | 86 | 35 | |

a. Italics indicate that Table 1 shows state requires balanced budget from any or all classes of municipalities. Note that city charter may supersede state requirements as in, for example, Philadelphia, Pittsburgh, and Virginia Beach.
b. Formal year-end deficit is prohibited; operating results must balance, but reserves and/or other tactics may be used to achieve operating balance.
c. Must rebalance quarterly.
d. As noted in Table 1, state statute is subject to varying legal interpretations.
e. Independently elected city comptroller certifies availability of funds.
f. Response of *don't know.*
g. City ordinance.
h. Federal law.
i. May not overexpend appropriations without budget amendment during fiscal year.

Source: Telephone interviews conducted 1992-1993 with finance or budget officials or analysts in reported cities. Population ranking is from U.S. Department of Commerce, Bureau of the Census (1991).

**Table 3**
**Patterns of Budgetary Balance in the Most Populous U.S. Cities**

| Population Quintile | Stage Required Submission | Adoption | Year End | Required at All Stages |
|---|---|---|---|---|
| Lowest 1st | 18 | 15 | 9 | 7 |
| 2nd | 17 | 16 | 8 | 6 |
| 3rd | 17 | 17 | 5 | 3 |
| 4th | 20 | 19 | 5 | 5 |
| Highest 5th | 12 | 19 | 7 | 3 |
| Total | 84 | 86 | 34 | 24 |

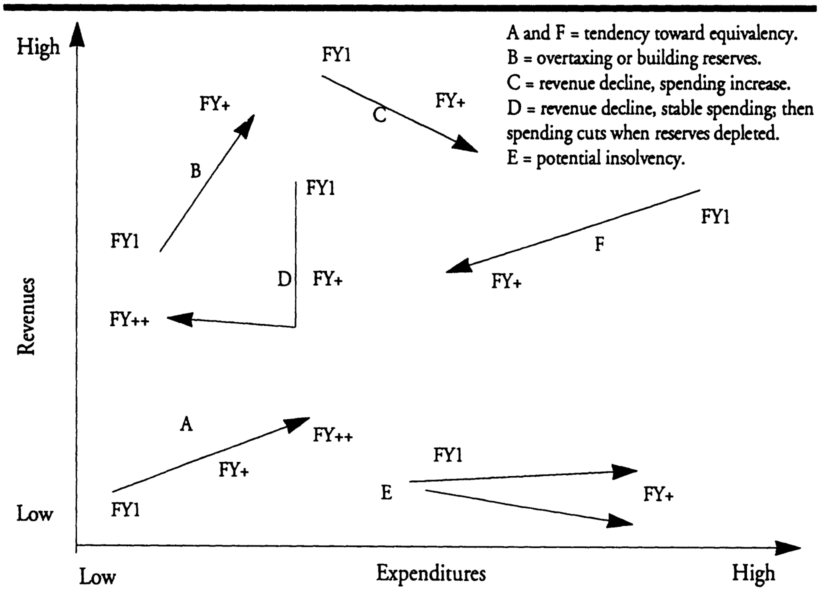
Source: Table 2.

ing is always a difficult one. All budgets start out initially out of balance.... The demands for spending always exceed the resources that are available, and this leads to...a conflict...throughout the budget process, and it leads to very difficult times in balancing budgets..."(pp. 6-7).

Figure 1 depicts how balance theoretically "forces discipline on budget actors" (Rubin, 1993; 164) by linking revenue and expenditure decisions. This push toward equivalence does not, however, prescribe which variable(s) to alter, or when. For all its power, balance does not dictate the levels of revenues and spending, but just that they be coupled. In this way, allowance is made for variability in revenue capacity, political and tax preferences, responsiveness, procedures, and other local characteristics.

The link is long term. "Fund balance does not refer to cash balance, nor is it the difference between revenues and expenditures. Rather, fund balance is the cumulative difference of all revenues and expenditures from the government's creation" (Allan, 1990; 1, note omitted). The presumed dynamic underlying municipal budgeting is that a municipality tends over several fiscal periods to move closer toward a balanced relationship, rather than further from it.[3] As Dickens' quote implies, balance usually is revenue driven, but the predictive power presumably holds only over the longer term for a particular jurisdiction, and many permutations are possible in any single fiscal year. Sustained imbalance with excessive revenues logically and empirically stimulates tax cuts. Budgetary imbalance loading on the spending side predictably leads to insolvency in the long term. Configuration E in Figure 1 depicts two budgetary patterns heading in this unsustainable direction.

**Figure 1**
**The Balance Model**




Budgetary balance is only one of many factors contributing to a jurisdiction's capacity and well-being, and says nothing about the quality of life in the community. Because any single measure of financial operations or condition necessarily includes and excludes selected factors and is intrinsically limited, it is useful to bear in mind George Bernard Shaw's (1904; 169) observation, "[T]he balance sheet of a city's welfare cannot be state in figures. Counters of a much more spiritual kind are needed, and some imagination and conscience to add them up, as well."[4]

## Imbalance versus Insolvency

The recent literature on budgeting (Rubin, 1993), fiscal stress and distress (Cope, 1992; Mackey, 1993; MacManus *et al.*, 1989; Wolman, 1983, 1992), urban politics and political economy (Judd and Kantor, 1992; Kantor and David, 1992), and municipal debt (Sbragia, 1983, 1992) offers alternative perspectives on fiscal capacity, stress, and insolvency. Seeming contradictions arise from different definitions and purposes. In *Evaluating Financial Condition,* Groves (1980) usefully distinguishes among four usages: *cash solvency* or short-term liquidity; *budgetary solvency* or fiscal-year balance; *long-run solvency* or balance; and *service-level solvency* that relates to meeting the community's service needs and/or demands.

## Insolvency and the Bridgeport Bankruptcy Case

The Bridgeport bankruptcy case illustrates the limits of the concept of budgetary balance and how it differs from insolvency. When the mayor of Connecticut's largest city (140,000 population) filed for Chapter 9 protection in June 1991, Bridgeport became the largest general purpose unit of government ever to petition under the federal Bankruptcy Code (Lewis, 1994). Moreover, "the city became a national symbol of urban despair when the former mayor filed for bankruptcy" (Lomuscio, 1992).

Finding that the city was not insolvent at the time of the June filing, Judge Alan H. W. Shiff expeditiously dismissed the petition on August 1. (Appeals and cross-appeals to U.S. District Court were pulled and finalized in February 1992, and a stipulation of dismissal approved without prejudice.)

Insolvency is defined in 11 U.S.C. Section 101 (32) (C) for purposes of bankruptcy: "with reference to a municipality, financial condition such that the municipality is—(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due ...". The jurisdiction bears the burden of proof. The Advisory Commission on Intergovernmental Relations (1985, p. 39, hereafter ACIR) noted, "The principal unresolved question remains how to define insolvency for purposes of permitting the use of the federal bankruptcy code." The Bridgeport case resolved this core concern. A member of the city's legal team had remarked with evident foresight, "It would be an irony if the city of Bridgeport was [sic] unable to file bankruptcy because it was in too solid financial health" (Scheffey, 1991a; 14). Because of the relatively restrictive definition of insolvency used by the court, this is precisely what happened.

In his memorandum of decision, Bankruptcy Court Judge Shiff (1991b) unequivocally stated, "Bridgeport's insolvency should be judged by a cash flow, not a budget deficiency, analysis." He further determined, "The [c]ity argues that since [sic] its expenditures will exceed its revenue, it has satisfied the burden of proving that it is insolvent. The [s]tate counters that if a prospective analysis is used, Bridgeport's solvency should be judged by a cash flow, not a budget deficiency, analysis. I agree with the [s]tate."

Proceeding from an altogether different perspective on insolvency, the city rejected the court's formulation. In its appeal (Bridgeport, 1991; 14-15), the city countered,

> The [c]ourt erroneously and without citing any legal precedent concluded that the ability of a municipality to "pay it's [sic] debts as they become due" can best and only be determined by a cash flow analysis. The [c]ity proposes that a cash flow analysis is only one, and not the most reliable, measure of a municipality's ability to "pay it's [sic] debts as they become due."... The court's cash flow standard is nowhere set forth in the Bankruptcy Act nor in any prior decisions.... Rather, the case law disfavors adoption of such an exact standard, and instead requires an analysis of the particular facts and circumstances of an individual case to determine insolvency.... Under the [c]ourt-adopted cash flow analysis, Bridgeport indeed may have limited cash on hand at a time when its budget process mandates it reduce spending and/or raise taxes, two non-viable options.

The city's appeal further argued that, "Cash flow analysis is but one part of a fiscal examination, it is not *the* fiscal examination. The [c]ourt erred in focusing so narrowly.... The bottom line result of the cash flow analysis is that Bridgeport is in dire financial straits yet will be denied Chapter 9 relief at a time when it is fast approaching a time certain when it will no longer be 'able to pay its debts as they become due'. Such a scenario could not have been contemplated or intended by Congress" (Bridgeport, 1991, p. 18).

Bridgeport's legal team (Bridgeport, 1991; 29) interpreted correctly but rejected the ruling. "If a municipality were to be limited by this [c]ourt's restrictively defined insolvency test in its access to the relief intended by Congress to be available through Chapter 9, then clearly Chapter 9 will have extremely limited application and utility." That the city was paying its creditors, covering the payroll, had cash on hand, and a substantial cash reserve (the latter restricted and extraneous to balancing the operating budget) was undisputed. The city's own finance and budget directors testified to these facts in court, and expert participants confirmed them in interviews with this author (Kirshbaum, 1992; Robinson, 1992; Savitsky, 1992). In fact, the city had promised in its initial petition to "guarantee the full payment of its debts with municipal bond holders and trade creditors." The argument concludes (Bridgeport, 1991; 29), "In a manner of speaking, the [c]ourt's ruling merely assures that Bridgeport will have money in its pockets when it dies."

Thomas Scheffey, in *The Connecticut Law Tribune* (1991b; 1), colorfully summarized the ruling as having "pegged Chapter 9 as little more than an oddball footnote in bankruptcy law, and not a powerful new tool to unsnarl the fiscal affairs of distressed cities.... The ruling sets out a one-to two-year test period in which a city must show more than that it's drowning in red ink. It must also be on the verge of exhausting all begged or borrowed cash, and about to start stiffing creditors, within that maximum 24-month period."

The inescapable lesson is that bankruptcy is an unavailing option for ameliorating fiscal stress defined as anything but insolvency and other issues are better addressed in other arenas. According to Bankruptcy Judge Shiff (1991b), broadening bankruptcy's scope is a congressional call: "The flaw in Bridgeport's argument is that the financial difficulties short of insolvency are not a basis for Chapter 9 relief. If such conditions are to be a criteria for municipal bankruptcy, Congress, not the courts, will have to make that change..." in the bankruptcy code.

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Leaving "the perennial question" of budgetary balance to the political arena, Shiff (1991b; 7) observed, "The answer in the first instance must come from the political process, not the courts. If, however, a city is insolvent...[and eligible under law], Chapter 9 may be used...but Chapter 9 is not available to a city simply because it is financially distressed."

Connecticut's Attorney General Richard Blumenthal (1991; 6) concurred, "The plain fact is that Chapter 9 does not provide a realistic solution for a major municipality in fiscal crisis. And the reason relates not only to specific provisions in Chapter 9—their defects or ambiguities—but more fundamentally to the nature of the financial difficulties faced by our major cities." Adding a political component, Blumenthal discerned, "A federal bankruptcy court clearly lacks—and constitutionally cannot be provided with—two ingredients essential to resolving the fiscal crises that plague our cities today: cash, and power." His conclusion is that "the bankruptcy process provides no real solution to a city facing long term, endemic problems.... As sympathetic as we must be to the problems and plight of our cities, bankruptcy isn't the solution."

### Prospective Insolvency

The Bridgeport case also clarifies the question of projected insolvency raised by the second clause of the statutory definition. The judge opined, "The conclusion that Section 101(32)(C)(ii) requires a prospective analysis also comports with the purpose of Chapter 9.... Cities cannot go out of business. Chapter 9 is intended to enable a financially distressed city to continue to provide its residents with essential services such as police protection, fire protection, sewage and garbage removal, and schools...while it works out a plan to adjust its debts and obligations."

A previous case involving the California school district of San Jose had raised the prospect of impending inability to meet financial obligations (Winograd, 1985). Here the court found that "the district was unable to meet its debts as they matured for the 1982-83 school year, was unable to balance its budget for the 1983-84 school year, and thus unable to meet its debts as they matured in the 1983-84 school year," and was insolvent for Chapter 9 purposes (ACIR, 1985; 39). Allowing for prospective insolvency is evident in the judge's statement that "if you can pay all your bills today, but everyone knows that you can't pay them tomorrow, then you would be eligible." The ACIR (1985; 39) observed, "The anticipated fiscal 1984 budget imbalance in San Jose that was used as a second basis for declaring insolvency also raises doubts about the definition of insolvency. At the time of filing, the school board still had over a year to make adjustments in both the revenue and expenditures sides of the 1984 budget.... [T]he claim of an unbalanced budget for 1984 seems somewhat premature."

In contrast, the core of the Bridgeport decision states, "to be found insolvent a city must prove it will be unable to pay its debts as they become due in its current fiscal year or, based on an adopted budget, in its next fiscal year" (Shiff, 1991b).

Until this ruling, neither legislative history nor case law specified the duration of the standard—how far into the future the cash-flow standard reaches. The newly minted standard deliberately forecloses premature evaluation by narrowing the window to the current fiscal year *and the next for which a budget has been adopted.* Accordingly, the judge determined, "A prediction at the commencement of this case that Bridgeport will be unable to pay its debts as they become due in the 1992-1993 fiscal year is unreliable. There are many reasons, not the least of which is the uncertainty of its cash position during a fiscal year for which there is not even a proposed budget." The new guideline establishes one fiscal year "as the 'target zone' in which a city must convincingly show it will run out of gas" (Scheffey, 1991c; 1).

Although the Bridgeport case clarified the insolvency standard for bankruptcy purposes, the court's ruling probably narrowed access to bankruptcy for the 86 of the 100 most populous cities in the country reported in as legally required to *adopt* a balanced budget (Table 3). The second clause of the insolvency test for eligibility is effectively nullified for these cities because they cannot show a duly adopted budget for the ensuing fiscal year as evidence of impending inability to pay debts. Because it is difficult to imagine a court's entertaining admission of other than a legally valid budget—and mandamus proceedings could overturn it—these cities effectively are limited to the first or *current cash* definition of insolvency. The widespread requirement for adopting a balanced budget means that the ruling retreated from the broad access the judge sought. In his first memorandum on Bridgeport, Judge Shiff (1991a; 14-15, citations omitted) declared, "[I]n general bankruptcy laws are to be liberally construed and ambiguities are to be resolved in favor of the debtor, so that the debtor receives the full measure of relief afforded by Congress."

### Balance in Bridgeport

Despite city leaders' unwillingness to shift to configuration F in Figure 1 and apparent preference for using the federal court to sustain configuration E, Bridgeport is legally obligated to end the fiscal year with a positive operating fund balance. Its experience illustrates the meaning of the stringent requirement for year-end budgetary balance shared by 34 percent of the most populous cities (Table 3).

Chapter 6 of the city charter charges the legislative body with responsibility for adopting a balanced budget: "The common council shall have no power to make appropriations in excess of the revenues of the city for any year, and in no case shall the expenses of the city exceed its revenue for any year, except in cases and for purposes for which the bonds are so issued." With respect to taxation, the charter (Chapter 7, Section 95) dictates that "the common council shall, by resolution, set a mill rate for the ensuing fiscal year, which shall, together with other sources of revenues, generate sufficient funds to support the budget adopted by the common council." The mayor as chief executive is responsible for "causing the laws to be executed and enforced within the city" and "to recommend the adoption of all such measures connected with the policy, security, health, cleanliness, and ornament of the city, and the improvements of its government and finances as he shall deem expedient" (Section 24). In 1990, the State Supreme Court ruled that this latter provision "does make it clear that the mayor is charged with oversight responsibility for the city's finances" (*William Hennessey* v. *City of Bridgeport et al.* 213 Conn, 656).

It was the city's inability to finance its pyramiding operating deficit without state approval that closed off the public credit markets in June 1988 and thrust the city into crisis. The state responded with a special act (*An Act Authorizing the Issuance of Bonds by the Town and City of Bridgeport,* Special Act 88-80, as amended) that created the Bridgeport Financial Review Board to oversee the city's finances, permitted the city to bond its operating deficit, and guaranteed $35 million in city bonds. According to Donald Kirshbaum (1992), the former executive director of the state's financial oversight board for the city, the act requires a strict modified accrual basis of accounting precisely in order to keep the cash flowing; to forestall borrowing from oneself, even an internal service fund may not run a negative balance; revenues must be in cash, in the bank, and the city is not allowed to carry any receivables on the balance sheet.[5]

The city's evidentiary testimony during the bankruptcy proceedings and the subsequent appeal bemoaned the unusually stringent budgetary and accounting practices imposed by the state's special legislation. Using garbled argumentation, the appeal attacked the court's insolvency standard because the city is required to budget on the basis of generally accepted accounting principles (GAAP). "The accrual [accurately, cash] versus the GAP [sic] accounting places the [c]ity in a different position when analyzing its cash flow because unlike other municipalities in the state it does not have the ability to carry over any expenses to the following fiscal year. The cash flow analysis with these restrictions and distortions simply should not have been applied in the present situation" (Bridgeport, 1991; 10-11). Pointing to a state-imposed basis of accounting more restrictive than for other Connecticut municipalities, the city's leaders (Bridgeport, 1991; 16) self-servingly argued that "unlike the other municipalities, [Bridgeport] can only include actual or reasonably expected revenues" and the "accounting method distorts the viability of a cash flow analysis and exposes it as an unreliable measure of the [c]ity's true financial condition. It must be remembered that the [c]ity has a legal obligation to balance its budget within the present fiscal year."

## The Discipline of Balance

While pleading for flexibility, city leaders were also making the somewhat perverse argument that they are foreclosed from using the expedients employed in other municipalities to formalistically comply with balance while actually evading it in a given fiscal year. Bridgeport simply must finance current services from current revenues.

Although the fact of balance itself might appear to outweigh the means of achieving it, the tactics actually employed inject policy content into budgetary balance. For example, Fitch (1993a; 2) ranks Cleveland's "[e]ffective budget measures resulting in a return to a positive year-end balance" as among this city's strengths. Such measures include "minimal wage increases for most employees, selective staff reductions, and health-care cost containment." From drawing down reserves or rainy day funds set aside for this very purpose to revenue *enhancements* (e.g., special assessment districts, user charges, service fees), and from *technical* reconciliations (e.g., adjusting the tax base) to David Stockman's notorious *magic asterisk,* anecdotal evidence points to more or less legitimate tactics suitable for the strategy of formalistic compliance with budgetary balance. These tactics are often stamped gimmicks—the stuff of smoke and mirrors—whereby they are painted as scheme or stratagem.

### Short-Term Contrivances

Ironically, one purpose of balance is to accommodate the very flexibility these labels censure.[6] Investment rating services appear to value this flexibility in their assessments. According to Standard & Poor's (1993; 22), "The fund balance position is a measure of an [debt] issuer's financial flexibility to meet essential services during periods of limited liquidity. Standard & Poor's considers an adequate fund balance to be a credit strength." To the question about Moody's assessment of large fund balances, Moody's (1993; 9) responds, "Large fund balances often reflect sound financial management, but not always...the fund balance is a measure of financial position, but financial structure is important as well."

Addressing correcting imbalance, Moody's recommends (1993; 8), "although such decisions are best made by local representatives, an issuer should keep in mind that strategies can differ for short-term versus long-term objectives.... If an operating imbalance is expected to persist, then the response should achieve ongoing budget balance while also maintaining essential service provision and an adequate physical plant." Very much to the point, Moody's (1993; 8) notes, "The reason behind an operating deficit can be more important than the deficit itself."

A long-term perspective is useful. San Antonio, the nation's tenth most populous city, is shown in Table 2 as operating under a stringent balance requirement. Although its operations have been balanced through tax increases and discriminating spending cuts, Fitch (1992; 1, 5) identifies a risk: "Future operating surpluses may be harder to achieve given the significant measures taken to realize budgetary balance to date." Table 5 indicates that the General Accounting Office (GAO) (1993b) assesses San Antonio as among the "fiscally weakest" cities in its study.

The literature on budgeting conveniently inventories both prosaic and exceptional techniques short of outright tax increases, service cuts, or cost reductions (Kennedy, 1991; Rubin, 1993; 164-206; Webber and Wildavsky, 1986). Examples of such techniques include: use of reserves; one-shot revenues such as asset sales; shifting costs off the general fund, interfund transfers, and shifting costs to the capital budget; underfunding accrued liabilities such as pensions; delaying deliveries, payrolls, and payments to the next fiscal year; estimation manipulation or distortion; using plugs such as anticipated and even unidentified (and perhaps illusory) savings or revenues; and turning to off-budget entities, indiscernible credit arrangements, loan guarantees, and tax expenditures. Not surprisingly, some entrenched techniques sacrifice efficiency for economy; for example, manipulation of employee benefits may translate into future cost escalations.[7] A testament to ingenuity, this litany accommodates tactics designed for both short-term flexibility and formalistic compliance.

As the Bridgeport case suggests, certain tactics derive from the nature of fund accounting, whereby "it is possible to balance the revenues and expenditures of the general fund, to which political attention is paid and to which balanced budget requirements apply, by making discrete transfers among funds or by budgeting selected activities in funds other than the general fund" (Granof and Mayper, 1991; 30). The basis of accounting may offer additional maneuverability. Whereas the data in Table 4 show that at least 19 states require generally accepted accounting principles for municipal financial *reporting*, municipal budgets "are generally on a cash or near-cash basis" (Granof and Mayper, 1991; 28).

Bridgeport's experience also suggests that estimation procedures are especially fruitful. Projecting a $16 million imbalance for the next fiscal year and a five-year projected deficit of $259 million (Bridgeport, 1991, p. 14), city leaders urged that insolvency be measured by long-term projections. The state alleged that the city's tale was "replete with distortions, inaccuracies, false assumptions and ignored options" (Connecticut, 1991; 35). Having allowed consideration of prospective balance, the bankruptcy judge "indirectly set a requirement for credible, complete budget predictions" (Scheffey, 1991c; 1). Adjusting estimates and projections is evidently common enough to have provoked legal remedies. For example, the independently elected city comptroller in Arlington, Texas, certifies the availability of funds (Table 2). The annotation accompanying Pennsylvania's statute (Section 2-302) specifies, "To prevent over-optimistic estimates by the body which must impose taxes...the [m]ayor's estimate of revenue yield is made binding upon the [c]ouncil. Until the budget is balanced, no money may be spent under the annual operating budget."

> [A]necdotal *evidence points to more or less legitimate tactics suitable for the strategy of formalistic compliance with budgetary balance. These tactics are often stamped gimmicks—the stuff of smoke and mirrors—whereby they are painted as scheme or stratagem.*

### Current-Year Balance versus Formal Compliance

Authentic compliance with budgetary balance represents the triumph of technical competence and administrative capacity. Webber and Wildavsky (1986; 592) point out, "The subject of budget balance as a rough equivalence between revenue and expenditure in total could hardly have arisen in modern form before the last 125 years or so, because methods of accounting were too imprecise.... [N]ew budgetary devices dominate modern governmental spending.... These new budget instruments either do not show up in the budget or, by much reducing the formal budget's size, serve to confuse the calculation of balances." They also ask (p. 592), "Nowadays, presumably, we know how far from this norm [of balance] we have wandered. Or do we?"

Recent research suggests some provocative answers. The declining frequency of current-year surpluses evident since 1988 (GAO, 1993b; Lamphere, 1990) is attributable to recession, fading or inadequate intergovernmental aid, and other factors, including idiosyncratic community features. In the Bridgeport case, the state (Connecticut, 1991; 41-42) cited the National League of Cities' finding that general expenditures exceeded revenues in 1991 for a majority of cities responding to its survey. Citing the same study, the GAO (1992; 56) finds, "Municipal and county [like many states'] fund balances have

**Table 4**
**19 States Requiring Generally Accepted Accounting Principles for Municipal Financial Reporting**

| | | | |
|---|---|---|---|
| Colorado | Kentucky | Nebraska | Oregon |
| Connecticut | Louisiana | Nevada | Virginia |
| Illinois | Maine | North Carolina | Wisconsin |
| Iowa | Massachusetts | Ohio | Wyoming |
| Kansas | Minnesota | Oklahoma | |

Source: Search of Lexis database conducted fall 1992 for generally accepted accounting principles, financial reporting, and by related key words.

also been depleted. For example, 59 percent of cities expected to draw down their fund balances in 1991. In addition, 39 percent of the nation's most populous counties and 34 percent of counties under 100,000 population experienced a budget shortfall in fiscal year 1991, thus reducing available local balances." (GAO's own study [1993b] confirmed declining year-end operating budget surpluses at all levels of government.)

In evidentiary hearings, the state's expert witness, Philip Dearborn, testified that, in the preceding two years, at least one-half of the 30 largest U.S. cities had unbalanced budgets in the sense that current revenues outstripped current expenditures and formal balance drew upon various contrivances. His and colleagues' subsequent analysis of financial reports for 28 of the 30 largest cities identifies a current-year imbalance for fiscal year 1990 in 25 cities (Dearborn, Peterson, and Kirk, 1992, Table 7). As shown in Table 5, 23 cities of the 25 are prohibited from formally adopting an unbalanced budget and 7 are prohibited from ending the year with an operating deficit. Corresponding credit ratings confirm the analytic inadequacy of using operating balance in a single fiscal year as the sole or even summary measure of financial performance or condition.

**Table 5**
**Current Budgetary Imbalance and Credit Ratings for Selected Cities, Fiscal Year 1990**

| Budget as Adopted[a] | GO Bond Rating[b] Moody's | GO Bond Rating[b] Standard and Poor's |
|---|---|---|
| Atlanta | Aa | AA |
| Baltimore | A1 | A |
| Boston | A | A |
| Buffalo[d] | Baaa1 | BBB+ |
| Cincinnati | Aa | AA+ |
| Cleveland[d] | Baa1 | A- |
| Columbus | Aa1 | AA+ |
| Dallas | Aaa | AAA |
| Denver | Aa | AA |
| Houston | Aa | AA |
| Indianapolis | Aaa | NR |
| Jacksonville | A1 | AA |
| Kansas City | Aa | AA |
| Memphis[d] | Aa | AA |
| Milwaukee[d] | Aa | AA+ |
| Minneapolis | Aaa | AAA |
| New Orleans[d] | Baa | A- |
| Philadelphia[d] | B | CCC |
| Pittsburgh | Baa1 | A |
| St. Louis | Baa | BBB |
| San Antonio[d] | Aa | AA |
| San Francisco | Aa | AA |
| Seattle | Aa1 | AA |
| **Year-End Results[c]** | **Moody's** | **Standard and Poor's** |
| Cincinnati | Aa | AA+ |
| Columbus | Aa1 | AA+ |
| Dallas | Aaa | AAA |
| Indianapolis | Aaa | NR |
| Phoenix | Aa | AA+ |
| San Antonio[d] | Aa | AA |
| Seattle | AA1 | AA |

a In these cities, the adopted budget must formally balance (Table 2) and current-year expenditures outstripped current-year revenues in the budget as adopted.
b. GO signifies general obligation bonds backed by the "full faith and credit" of the jurisdiction.
c. In these cities, year-end operations must balance (Table 2) and a current gap was offset using more or less legitimate devices.
d. Identified by the U.S. General Accounting office in 1993 as among the "fiscally weakest" quartile of cites.
Source: Table 2; U.S. General Accounting Office (1993b; 112-113); budget data from Dearborn, Peterson, and Kirk (1992, Table 7); and bond ratings from "The Top 50 Cities, 5th Annual Financial Report" (1990; 12-13).

## Conclusion

The evidence presented here confirms empirically the pivotal role of balance in municipal budgeting. Findings show that budgetary balance is, in fact, a common legal requirement and, perhaps more importantly, is articulated as an operative norm by participants in the budgetary process. Bridgeport's brief flirtation with bankruptcy cautions against overrating the power of balance as budgetary disciplinarian. Given the many devices for achieving formal compliance, balance need not and often does not translate into equivalency between current revenues and current expenditures.

Municipal budgeting cannot be reduced fruitfully to a single criterion, even one as widely accepted as budgetary balance. Bound by charter and statute, Bridgeport's city leaders unavailingly sought to bypass the strictest of balance requirements *via* federal bankruptcy court. Their contribution to municipal budgeting and "[t]he net gain for bankruptcy law...may be just that cities contemplating a bankruptcy know how to plan for it better" (Scheffey, 1991b; 1). Although the fiscal woes of many U.S. cities has heightened interest in bankruptcy (Cohen, 1991), the case demonstrates that while "persistent balance sheet deficits" are among the several financial warning signs (Standard & Poor's, 1989; 12), balance is most usefully distinguished from insolvency and that tactics underlying the balance and other factors warrant attention. Further undercutting the power of a concept whose attraction is related in no small measure to its simplicity, this conclusion calls to mind H. L. Mencken's observation, "For every human problem, there is a solution that is simple, neat, and wrong."

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1. The GAO (1993; 3) found that all but Vermont and Wyoming among the 50 states have balanced budget requirements. "In most states, the balanced budget mandates apply to enacted budgets or to the governors' proposed budgets. Few balanced budget requirements specifically mandate year-end balance."
2. The ACIR (1993; 46) identified only eight states mandating by constitution or statute that city budgets be balanced.
3. This expectation is predicated upon the presumedly universal desire to reduce uncertainty and enhance stability. "Two important goals of local governments are the maintenance of a stable tax and revenue structure and the orderly provision of services to residents" (Allan, 1990; 2).
4. In this regard, only Kentucky, Pennsylvania, and Ohio of the 13 states with statutory provisions specify budgetary imbalance among the criteria triggering assistance to local governments with "severe, immediate fiscal problems" (Mackey, 1993; 3-6).
5. Section 11 of the act specifies that the financial plan under the aegis of the review board "shall provide for the: (1) Elimination of all deficits in the general fund; (2) restoration to all funds and accounts, including capital funds and accounts, of any moneys from such funds and accounts that were used for purposes not within the purposes of such funds and accounts or borrowed from such funds or accounts; (3) balancing of the operating funds in accordance with the provisions of this act."
6. According to the GAO (1993b; 10), "many jurisdictions had fewer year-end budget

funds to carry forward to help finance the succeeding year's programs, suggesting a diminished flexibility, at least in the short-run, to increase the funding of current services or undertake major new spending initiatives."

7. "In addition to the hidden costs of benefits, Moody's is seeing salary increases that are partially funded with changes in actuarial pension earnings assumptions, an approach that requires fewer operating fund dollars today. Although this approach may be appropriate for cities with historically conservative assumptions, such changes require careful actuarial scrutiny, and funding levels must be revisited frequently to assure that the more aggressive earnings assumptions are, in fact, being achieved" (Kennedy, 1991; 3).

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